JUL 10 2002

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

FEDERAL TRADE COMMISSION, Plaintiff, v. CYBERSPACE.COM, LLC, *et al.*, Defendants.	No. C00-1806L ORDER GRANTING IN PART PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT AND DENYING DEFENDANTS' MOTIONS FOR SUMMARY JUDGMENT

This matter comes before the Court on "EFO Defendants' Motion for Summary Judgment," "Defendants Chris Hebard and Coto Settlement's Motion for Partial Summary Judgment," and "Plaintiff's Motion for Summary Judgment."[1] The Federal Trade Commission ("FTC") asserts that defendant Cyberspace.com, LLC ("Cyberspace") and its sister companies, Essex Enterprises, LLC ("Essex"), Surfnet Services, LLC ("Surfnet"), and Splashnet.net, LLC ("Splashnet"), used deceptive marketing practices to sign individuals and small businesses up for internet services between January 1999 and mid-2000. The four sister companies were all owned by defendant Electronic Publishing Ventures, LLC ("EPV"), which in turn was owned in equal parts by defendants French Dreams Investments, N.V. ("French Dreams) and Coto

[1] Defendants requested oral argument on their motions for summary judgment, but not on the FTC's motion. The matters raised in these motions can be determined on the papers submitted by the parties: defendants' requests for oral argument are, therefore, DENIED.

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Settlement. French Dreams is owned by defendant Ian Eisenberg and Coto Settlement is owned by defendant Chris Hebard. In addition, defendant Eisenberg owns 100% of defendant Olympic Telecommunications, Inc. ("Olympic"), a separate company which made billing arrangements and provided customer service for the four sister companies.

Defendants Cyberspace and EPV failed to respond to the FTC's complaint: default judgments have been entered against them. Defendants Eisenberg, Olympic, French Dreams, Hebard, and Coto Settlement have agreed to and are bound by the terms of a stipulated permanent injunction that was signed by the Court on October 23, 2000. The FTC requests that the Court subject the defaulting defendants to the terms of the stipulated permanent injunction, grant summary judgment on the deceptive practice claims, and hold defendants jointly and severally liable for $24,208,235.92 in consumer restitution and disgorgement. Defendants seek a summary determination that their statements, acts, omission were not deceptive under 15 U.S.C. § 45(a).

Summary Judgment Standard

Summary judgment is appropriate when, viewing the facts in the light most favorable to the nonmoving party, there is no genuine issue of material fact which would preclude summary judgment as a matter of law. "Once the FTC has make a prima facie case for summary judgment, the defendant cannot rely on general denials but must demonstrate with evidence that is 'significantly probative' or more than 'merely colorable' that a genuine issue of material fact exists for trial." FTC v. Gill, 265 F.3d 944, 954 (9th Cir. 2001) (quoting Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249-50 (1986)).

Factual Background and the Solicitations

In 1998, defendants Eisenberg and Hebard began investigating the use of solicitation checks as a means of marketing internet services. Using wholly-owned companies, Eisenberg and Hebard formed defendant EPV and its four subsidiaries, Cyberspace, Essex, Surfnet, and Splashnet. Between January 1999 and mid-2000, the four sister companies mailed approximately 4.4 million solicitations, 3.3 million of which were sent to small businesses and the remaining 1.1 million were sent to individuals. The solicitations varied in style, but all of them included a check, usually in the amount of $3.50, with an attached form that looked like an invoice made up of columns and descriptive phrases such as "invoice number," "reference number," "date," "discount taken," *etc.*[2] The check was made out to the individual or small business to whom it was sent, with the consumer's phone number in the "re" line. See Affidavit of Defendant Ian Eisenberg (filed 3/7/02), Exhibit A. The fronts of the checks and the invoices were generally devoid of any indication that the mailing was an offer for services or that by cashing the check, the consumer was contracting for internet access. See Affidavit of Defendant Ian Eisenberg (filed 3/7/02), Exhibit A at FTC-0001386. Where there was an indication that the check/invoice might be more than it appeared on the surface, the information provided was vague (see Affidavit of Defendant Ian Eisenberg (filed 3/7/02), Exhibit A at FTC-0001418), microscopic (see Affidavit of Defendant Ian Eisenberg (filed 3/7/02), Exhibit A at FTC-0001474), and/or not widely used (see Affidavit of Defendant Ian Eisenberg (filed 3/7/02), Exhibit A at FTC-0001381; Declaration of Chris Hebard at ¶ 5 (filed 3/7/02)).

On the back of the check and the back of the invoice, the solicitations contained fairly detailed disclosures regarding the services offered, the terms on which they would be provided, and the consequences of endorsing the check. The FTC does not contend that these disclosures were unclear or misleading, but rather asserts that (1) the combination check/invoice misled recipients into believing that the check was a rebate or refund and (2) the placement of the disclosures on the back of the check in lengthy paragraphs of small print made them inconspicuous. Along with the check/invoice document, most of the solicitations also included an advertising insert touting the importance of good internet access and the offeror's ability to provide it "for the low, low price of only $29.95 per month, which, when the enclosed check is endorsed and cashed or deposited, will be billed conveniently to the customer's local phone bill." See Affidavit of Defendant Ian Eisenberg (filed 3/7/02), Exhibit A at FTC-0001448-49.

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[2] The only exception to the check/invoice format in the record is a solicitation created for Splashnet which may or may not be complete. See Plaintiff's Exhibit 65. In describing their marketing scheme, defendants Hebard and Eisenberg testified that the solicitations included both a check and a "check stub." Affidavit of Defendant Ian Eisenberg at ¶ 14 (filed 3/7/02); Declaration of Chris Hebard at ¶ 5 (filed 3/7/02).

Federal Trade Commission Act

Section 5 of the FTC Act, 15 U.S.C. § 45(a)(1), prohibits "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce." An act or practice is deceptive if "first, there is a representation, omission, or practice that, second, is likely to mislead consumers acting reasonably under the circumstances, and third, the representation, omission, or practice is material." FTC v. Pantron I Corp., 33 F.3d 1088, 1095 (9th Cir. 1994) (quoting and adopting standard in Cliffdale Assocs., 103 F.T.C. 110, 164-65 (1984)), cert. denied, 514 U.S. 1083 (1995). Because "[d]eception may result from the use of statements not technically false or which may be literally true," the test under Section 5 considers the net impression created by a solicitation, not just its individual parts. United States v. 95 Barrels of Vinegar, 265 U.S. 438, 443 (1924); Sterling Drug, Inc. v. FTC, 741 F.2d 1146, 1154 (9th Cir. 1984), cert. denied, 470 U.S. 1084 (1985).

Having reviewed the pleadings, declarations, and exhibits submitted by the parties and having considered all of the evidence in the light most favorable to the non-moving parties, the Court finds as follows:

Deceptive Acts or Practices

In the absence of a clear and conspicuous disclosure regarding the effect of endorsing and cashing the enclosed check, the EPV subsidiaries' use of a solicitation check combined with the invoice-like form is a representation that the check constitutes payment on some pre-existing debt or obligation, such as a rebate, refund, reimbursement, or payment for goods/services rendered. Consumers, whether they be individuals or small businesses, have some right to expect that the purveyor of services would want to tell potential customers that they have something to sell and to explain the benefits, if not the absolute necessity, of purchasing the product or service. The receipt of a check, the perusal of which would reveal no obvious mention of an offer for services, no product information, and no indication that a contract is in the offing, coupled with an invoice that has no advertising or solicitation purpose, creates an overall impression that the check resolves some small, outstanding debt. Cashing such a check without further investigation, while not advisable in today's cutthroat and rather underhanded advertising world, is reasonable in the circumstances presented here. Having created a false impression in the minds of the recipients and having lulled consumers into believing that the check is nothing more than a check, the four sister companies cannot escape liability by including fine print disclosures (especially when hidden on the back of the check/invoice) and/or filling the envelope with advertisements.

Even if the record before the Court contained nothing more than the examples of solicitations attached as Exhibit A to the Affidavit of Defendant Ian Eisenberg, there would be ample evidence from which to find that the EPV subsidiaries engaged in deceptive acts or practices that were likely to mislead consumers acting reasonably under the circumstances. As discussed above, the solicitations contain false representations of a pre-existing relationship[3] and, rather than touting the services that were ultimately foisted upon the unwary consumer, literally hide the offer and its terms behind the facade of a rebate or payment. Had the sister companies' primary purpose been to identify customers who would knowingly chose to enter into a contract for the provision of internet services, the solicitations would have been formatted very differently in order to highlight the services that were being offered and to explain the benefits of contracting with Cyberspace, Essex, Splashnet, and/or Surfnet. Instead, the EPV subsidiaries developed and used a system through which there was a significant likelihood that consumers, being misled by the false impression created by the check/invoice combination, would sign what they believed to be a straightforward check without realizing that their signature also created a contract.[4] As one irate recipient of defendants' solicitation stated:

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[3] Defendants do not allege that the four sister companies had pre-existing relationships with the recipients of their mailings.

> You are kidding yourselves into thinking that you are going to gain a consistent user base through this method of misinformation and in persuing [sic] this approach you are only serving to demonstrate that you do not believe your service is worthwhile to stand on its own merits, rather you must trick people into subscribing. . . . This method of marketing only serves to shout to the world that you are only a temporary fling and you are hoping to make a quick buck through accidental subscribers thinking they are cashing a legitimate check.

Plaintiff's Exhibit 154 (e-mail from Daniel Underhill, dated 6/10/99).

Although Mr. Underhill was not fooled by the form of the solicitation, he put defendants on notice that the check/invoice format gave the impression that it was a payment or rebate of some kind and was "deceptive." Plaintiff's Exhibit 154 ("I received your 'check' in the mail today for $3.50. I scratched my head for the longest time trying to figure out who the heck I had invoiced for $3.50 or for what rebate I was receiving this check. Then I read the fine print on the check stub. Let me just say that I think your deceptive marketing practices are an insult to my intelligence and to the population at large. The check states that upon cashing it I have accepted you as my ISP and your services. Even though it does state this clearly on the check stub (albeit after some reading), you are clearly banking on the notion that most people won't examine too closely as to what the check is for and who it is from and will just cash it with the next bank deposit.").[5]

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[4] Paraphrasing the holding of a D.C. Circuit opinion, "[t]here can be no reasonable doubt, and petitioners plainly do not doubt, that if they used the words ['endorse this check and we will provide you with internet services for only $29.95 per month, billed conveniently to your phone bill'] they would get few replies. Their [solicitation] succeeds in conveying the false impression it must convey in order to achieve its purpose." Bennett v. Federal Trade Commission, 200 F.2d 362 (D.C. Cir. 1952).

The misleading and deceptive nature of the check/invoice solicitations is not only plain on its face, but is also proved by its results. Letters and testimony in the record show that some of the recipients were deceived by the form of the solicitation or, at the very least, ended up paying for a service that they did not want and/or could not use. See Plaintiff's Exhibit 77 (complaint from The Intimate You Beauty Salon, dated 11/11/99, and responses from defendants Olympic and Cyberspace); Plaintiff's Exhibit 134 (complaint from Enchantment Contracting, dated 9/28/99, and responses from defendants Olympic and Cyberspace); Plaintiff's Exhibit 268 at 37 and 69-70 (Robrecht Deposition); Plaintiff's Exhibits 270, 274, 278, and 298 (consumer declarations).[6] In addition, defendants knew that very few of their "customers" ever used the service for which they had contracted. See Plaintiff's Exhibit 4 (monthly invoices from StarNet, the provider of the internet services marketed by defendants' companies, showing that less than one percent of the customers being billed for internet services between August 1999 and November 2000 actually logged on).[7] Defendants' internal e-mails and documents show that they were aware that many of their customers had responded to the marketing scheme without realizing that when they deposited the solicitation check, they contracted for internet services. Plaintiff's Exhibits 74, 80, and 95 at E-0020094.[8]

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[5] E-mails and letters of complaint from recipients of the solicitations are admissible both to show notice and to show the truth of the matters asserted under the residual hearsay exception set forth in Fed. R. Ev. 807. First, the fact that individuals were confused and/or that they cashed the solicitation checks without realizing that they were contracting for internet services is material to this case. Second, reasonable efforts would not produce evidence that is more probative than these contemporaneous e-mails and letters. As noted in FTC v. Figgie Int'l, Inc., 994 F.2d 595, 608-09 (9th Cir. 1993), bringing each complainant into court to testify, under oath, that the contents of their letters were true would be an unreasonable exercise and would not necessarily result in testimony that is any more trustworthy than the complaints themselves. Third, admitting the e-mails and letters will make relevant evidence available for consideration and provides an efficient means by which the FTC can show consumer confusion and injury. Fourth, defendants have had a fair opportunity to review the FTC's evidence and to prepare to meet it. Finally, the e-mails and letters have circumstantial guarantees of trustworthiness that are equivalent to the enumerated hearsay exceptions. "The letters were sent independently to the FTC [defendants, and other government agencies] from unrelated members of the public. The fact that they all reported roughly similar experiences suggests their truthfulness. Furthermore, the declarants had no motive to lie [regarding their experiences and there is little risk that the complaints] were the product of faulty perception, memory or meaning, the dangers against which the hearsay rule seeks to guard." Figgie Int'l, 994 F.2d at 608 (internal quotations omitted).

The Court finds that, as a matter of law, check/invoice combinations that do not clearly and conspicuously disclose the effects of cashing the check and/or clearly state that the check is an offer for the sale of internet services on the face of the document constitute material representations that are likely to mislead consumers acting reasonably under the circumstances. The invoice design misrepresents the relationship between the parties and makes the otherwise accurate but inconspicuous disclosures insufficient. Because the solicitation was likely to mislead consumers into depositing the check without realizing that their endorsement created a contract with the EPV subsidiaries, Olympic's implied and express representations that consumers were bound by the contract, either for past or future payments, were also misleading.

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[6] FTC concedes that there were some production problems with Plaintiff's Exhibits 271, 272, 275, 276, 279-84, 286-93, and 295-97. The Court has not considered those declarations in ruling on the motions for summary judgment. In addition, where a declarant did not personally deposit the solicitation check and/or has no personal knowledge of why the check was deposited, any hearsay statements regarding motivation or intent were not considered.

[7] Defendants' objections to the StarNet invoices are overruled.

[8] Defendants' objections to Plaintiff's Exhibit 95 are overruled. Defendant Eisenberg produced this document and admitted its authenticity in response to requests for admission. Defendant Hebard was shown Exhibit 95 during his deposition and stated that it appeared to be the package defendants put together to sell the EPV companies. Plaintiff's Exhibit 260 at 175-76. In the context of the entire document and defendants' attempts to explain the unusually high churn rate experienced by the EPV subsidiaries, Exhibit 95 shows that defendants knew that their chosen marketing strategy generated "customers" who never actually intended to subscribe. Defendant Eisenberg offers no evidence in support of his proposed addition to the sentence on E-0020094 and, in the context of the rest of the page, it is strained and unpersuasive.

Defendants' Liability

The next issue is whether the non-defaulting defendants are liable for the statutory violations of the EPV subsidiaries and Olympic. Defendants do not dispute that Chris Hebard, EPV, and EPV's parent corporations, French Dreams and Coto Settlement, are liable for the subsidiaries' misconduct. Defendant Eisenberg, however, argues that he did not have sufficient knowledge regarding the form of the solicitations or consumer complaints to be held personally liable for the corporations' misconduct. See Affidavit of Defendant Ian Eisenberg at ¶¶ 10, 14, 15, and 19. Individuals are personally liable for consumer restitution if they "had knowledge that the corporation or one of its agents engaged in dishonest or fraudulent conduct, that the misrepresentations were the type upon which a reasonable and prudent person would rely, and that consumer injury resulted." FTC v. Publishing Clearing House, Inc., 104 F.3d 1168, 1171 (9th Cir. 1997). This requirement is satisfied if the "individuals had actual knowledge of material misrepresentations, were recklessly indifferent to the truth or falsity of a misrepresentation, or had an awareness of a high probability of fraud along with an intentional avoidance of the truth." FTC v. Affordable Media, LLC, 179 F.3d 1228, 1234 (9th Cir. 1999) (internal quotations omitted).

There is ample evidence in the record that defendant Eisenberg was directly involved in the development of the deceptive marketing scheme used by the EPV subsidiaries, that he reviewed at least some of the solicitation forms before they were mailed, that he knew very few subscribers used the internet services for which they were being billed, and that he was aware that some of the consumers who had cashed the solicitation checks did not realize they had contracted for internet services. See, e.g., Plaintiff's Exhibit 60 (Hebard Dep. Tr. at 60-61);

Plaintiff's Exhibit 148 (e-mail from Eisenberg determining how many solicitations to mail); Plaintiff's Exhibits 68 and 146 (proposed solicitations sent to Eisenberg for review); Plaintiff's Exhibit 80 (e-mails sent to Eisenberg discussing the relationship between the high number of customers cancelling service on one hand and the low user rates and manner in which the service is marketed on the other); Plaintiff's Exhibits 153 and 154 (e-mails regarding consumer complaints in which Eisenberg took part). Eisenberg's affidavit contains little more than an assertion that he was less involved in the daily operations of the EPV subsidiaries than was defendant Hebard. The evidence shows, however, that he had and exercised control over all of the corporate entities except Coto Settlement, that he was actively involved in developing the misleading solicitations at issue here, and that he knew of, or at the very least was recklessly indifferent to, the resulting consumer injuries. Eisenberg's conclusory, self-serving affidavit, lacking detailed facts and any supporting evidence, is insufficient to create a genuine issue of material fact. Hansen v. United States, 7 F.3d 137, 138 (9th Cir. 1993). Eisenberg is, therefore, personally liable for the corporate misconduct discussed above.

Damages

For all of the foregoing reasons, the FTC is entitled to a summary determination that the check/invoice solicitations mailed by Cyberspace, Essex, Surfnet, and Splashnet violated Section 5 of the FTC Act. The FTC has also shown that, as a matter of law, all defendants are jointly and severally liable for the corporate misconduct of the EPV subsidiaries. The Court cannot, however, determine the amount of defendants' liability from the record as it currently stands. FTC has calculated that defendants' solicitations cost consumers $24,208,235.92 in total unreimbursed payments. This amount was calculated by taking the total charges billed by Olympic ($29,318,038.39) and subtracting the amounts consumers received by cashing the solicitation checks ($899,500), through local exchange carrier credits ($3,091,302.47), and through refunds ($1,119,000).[9] The Court does not, however, adopt plaintiff's damage calculation at this time because (1) plaintiff has not adequately explained the adjustments made after reviewing Olympic's interrogatory responses and (2) defendants have raised legitimate issues regarding the propriety of using Olympic's billing records, rather than actual payment records, as the starting point for the damage calculation.[10] Defendants' objection that the amount of consumer redress exceeds the amount by which they profited from the check/invoice solicitation scheme is unpersuasive and legally deficient. The Ninth Circuit has already determined that the proper measure of consumer restitution is the amount that will restore the victims to the *status quo ante*, not what defendants received as profit. Figgie Int'l, 994 F.2d at 606-07. Although it appears that the FTC is entitled to summary judgment regarding a substantial portion of its consumer redress figure, additional evidence is required before an accurate calculation can be made.

Plaintiff's motion for summary judgment is GRANTED as to liability but DENIED as to damages. The defaulting defendants, Cyberspace and EPV, are hereby subjected to the terms of the stipulated permanent injunction that was entered by the Court on October 23, 2000. Defendants' motions for summary judgment are DENIED. The parties shall contact the chambers of the Honorable Ricardo S. Martinez at (206) 553-1396 to reschedule their mediation. If the parties are unable to settle this matter based on the rulings set forth in this Order and with the assistance of Judge Martinez, the Court may request additional briefing regarding damages, the FTC's plan for distributing funds to injured consumers, and the procedures to be used to resolve the outstanding damage issues.

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[9] Defendants' objections to Plaintiff's Exhibit 302 (Declaration of Lisa M. Tobin) are overruled. As was the case in Figgie Int'l, Ms. Tobin's summary of defendants' billing records is admissible under Fed. R. Ev. 1006 as long as defendants had an opportunity to examine the underlying documents and data (which, in this case, were produced by defendants in the first instance). 994 F.2d at 608.

[10] Defendants argue that the FTC's consumer redress figure is inflated because it includes amounts paid by customers who actually used the internet services, charges that were simply never paid by customers, and some unspecified additional amounts that the local exchange carriers have credited, or will credit, to consumers.

DATED this 10th day of July, 2002.

Robert S. Lasnik
United States District Judge